Supreme Court, U.S.
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In The
Supreme Court of the United States

ROBERT E. RILEY, JR. AND SHEILA CANTRELL, AS TRUSTEES OF, AND PARTICIPANTS IN, THE PERFORMANCE TOYOTA, INC. 401(K) PROFIT SHARING PLAN, ON BEHALF OF THEMSELVES AND ON BEHALF OF ALL OTHER SIMILARLY SITUATED PARTICIPANTS IN THE PLANS AND SHAREHOLDERS OF THE MERRILL LYNCH GROWTH FUND,

Petitioners,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; MERRILL LYNCH GROWTH FUND; MERRILL LYNCH ASSET MANAGEMENT, L.P.; AND ARTHUR ZEIKLE, JAMES H. BODURTHA, HERBERT I. LONDON, ROBERT R. MARTIN, JOSEPH L. MAY AND ANDRE F. PEROLD, ALL AS THE TRUSTEES OF THE MERRILL LYNCH GROWTH FUND,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

The question presented in this litigation is one of first impression. It represents the first appellate challenge to the constitutionality of the Securities Litigation Uniform Standards Act of 1998, or "SLUSA" (15 U.S.C. §77p and 15 U.S.C. §78bb). The Petitioners' question is:

Does intra-state litigation arising out of actions occurring in Florida and based upon Florida statutes constitute interstate commerce which can be regulated by the United States Congress through SLUSA?

PARTIES TO THE PROCEEDING

The Petitioners are Robert E. Riley Jr. and Sheila Cantrell, as trustees of and participants in the Performance Toyota, Inc. Profit Sharing Plan ("Performance Plan"), on behalf of themselves and other Florida shareholders of the Merrill Lynch Growth Fund.

The Respondents are Merrill Lynch, Pierce, Fenner & Smith, Inc.; the Merrill Lynch Growth Fund; Merrill Lynch Asset Management, L.P.; and the Trustees of the Merrill Lynch Growth Fund.

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PETITION FOR A WRIT OF CERTIORARI

The Petitioners petition for a writ of certiorari from an opinion rendered by the United States Court of Appeals for the Eleventh Circuit.

OPINIONS BELOW

The Eleventh Circuit's opinion dismissing with prejudice all Petitioners' claims on the basis of SLUSA is reported at *Riley v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 292 F.3d 1334 (11th Cir. 2002). The opinion of the district court is reported at 168 F. Supp. 2d 1352 (M.D. Fla. 2001).

JURISDICTION

The Eleventh Circuit's opinion was entered on June 7, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1), and Supreme Court Rule 10(a). This Petition involves the first reported appellate challenge to the constitutionality of SLUSA.

CONSTITUTIONAL & STATUTORY PROVISIONS INVOLVED

In addition to SLUSA, just resolution of this case requires the Court to consider the Commerce Clause of the United States Constitution (art. I, §8) and the Constitution's Tenth Amendment of December 15, 1791 (amend. X). The Petitioners' state law statutory claims were brought pursuant to the Florida Securities and Investor Protection Act (Chap. 517 *et seq.*, FLA. STAT. (2001)) and the Florida

Deceptive and Unfair Trade Practices Act, §501.201 *et seq.*, FLA. STAT. (2001). Because this Petition draws the constitutionality of an Act of Congress into question, 28 U.S.C. §2403(a) and Supreme Court Rule 29.4(b) require service of this Petition upon the Solicitor General of the United States.

STATEMENT

This case of first impression challenges the constitutionality of SLUSA. The statutory scheme established by SLUSA does not attempt to regulate securities markets. As SLUSA's title indicates, SLUSA attempts to regulate litigation. SLUSA does not preempt or replace the substantive law of the states. Rather, SLUSA divests citizens of their right to otherwise available state remedies, if 50 or more plaintiffs are aggregated in a common intra-state scheme.

SLUSA provides that "no covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal Court by any private party alleging – (1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or (2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security." The Eleventh Circuit, in rejecting the Petitioners' challenge to SLUSA's constitutionality, stated: **"SLUSA regulates only national securities markets. . . . "** *Riley v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 292 F.3d at 1347.

SLUSA does not do what the Eleventh Circuit said it does. It does not regulate national securities markets. Instead, SLUSA attempts to regulate intra-state litigation,

and is an impermissible attempt by Congress to federalize Florida's court system. This unconstitutional foray by Congress into Florida's state sovereignty is barred by the United States Constitution's Commerce Clause.

The procedural background of the dispute is contained in the appellate opinion. The Petitioners, Florida residents all, are Trustees of and participants in their respective retirement plans. The Petitioners sued the defendants for their activities in Florida under two Florida statutes, the Florida Securities and Investor Protection Act (FLA. STAT. §517.011 *et seq.*) and the Florida Deceptive and Unfair Trade Practices Act (FLA. STAT. §501.201 *et seq.*) No common law claims and no federal claims were alleged.

Initially, the Petitioners sued the defendants in federal court. *Riley v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 292 F.3d at 1336. The defendants moved to dismiss on the basis that SLUSA provided a complete defense to Petitioners' state law claims. The district court *sua sponte* ordered the Petitioners to show cause why their Complaint should not be dismissed for lack of jurisdiction and the Performance Plan, detecting a potential problem relating to the jurisdictional amount in controversy, refiled its exact same Florida statutory claims in Florida state court. The defendants sought removal of the Performance Plan's state court case back to federal court, where the district court proceeded to dismissal all claims with prejudice, based on SLUSA.

The district court and the appellate court rejected the Petitioners' arguments that SLUSA could not constitutionally apply to an intra-state case brought exclusively under Florida statutes by Florida residents. This decision has effectively deprived the Petitioners of any forum

(either state or federal) for redress of their Florida statutory claims.

SLUSA is an unconstitutional attempt by Congress to regulate intra-state litigation, and it impinges on the ability of the states to pass laws and provide remedies for wrongdoing occurring within the state's borders. SLUSA, simply put, has nothing to do with regulation of the national securities markets. Rather, SLUSA impermissibly regulates intra-state litigation and deprives state residents of their state remedies once more than 50 victims (either individually or as a class) seek a state court remedy for their damages arising out of conduct occurring within their state. Congress's use of SLUSA to federalize the court systems of the various states is unconstitutional.

This Court has repeatedly held in recent years that even a possible impact on national commerce is not a sufficient basis for congressional intrusion. *U.S. v. Lopez*, 514 U.S. 549 (1995); *U.S. v. Morrison*, 529 U.S. 598 (2000); *Solid Waste Agency v. U.S. Army Corp. of Eng.*, 531 U.S. 159 (2001). The Eleventh Circuit failed to consider or distinguish any of those authorities, despite the Petitioners' presentation of them in its appellate briefs. Under the United States Constitution's Tenth Amendment, the powers not delegated to the United States "are reserved to the States respectively, or to the people." By way of illustration, every state has the right to provide anti-fraud laws for the protection of that state's residents, and Florida has specifically done so by enacting Chap. 501 and Chap. 517. If SLUSA was truly "preemptive," every case alleging state law violations in connection with the purchase or sale of securities would have to be federalized – and not just those where 50 or more plaintiffs are involved.

SLUSA has bizarre consequences which violate the United States Constitution's Due Process Clause as well, because the statute on its face provides for removal and dismissal of suits based on state law only when a class is asserted or more than 50 plaintiffs are involved. Smaller cases based on exactly the same facts and circumstances can proceed. This incongruous result leads to injustice; wrongdoers who damage more than 50 individuals are provided with a complete procedural defense to intra-state claims, while lesser wrongdoers (those injuring less than 50 plaintiffs) can be held accountable. No rational basis can support this result. This is because SLUSA does not regulate securities markets, but rather, attempts to regulate intra-state litigation. Neither logic nor equity can render constitutional a statute which prevents the citizens of a state from enforcing their rights, where the actions complained of occurred within the state and relief is sought under the laws of that state by the residents of the state.

CONCLUSION

For all of the above reasons, the petition for a writ of certiorari should be granted.

September 5, 2002

Respectfully submitted,

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[PUBLISH]

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 01-16150

D.C. Docket No. 00-02335-CV-T-30B

ROBERT E. RILEY, JR., as trustee of, and participant in, the Performance Toyota, Inc. 401(k) Profit Sharing Plan, on behalf of himself and on behalf of all similarly situated participants in the plans and shareholders of the Merrill Lynch Growth Fund, SHELIA CANTRELL, as trustee of, and participant in, the Performance Toyota, Inc. 401(k) Profit Sharing Plan, on behalf of herself and on behalf of all similarly situated participants in the plans and shareholders of the Merrill Lynch Growth Fund, GREGORY D. DINGLE, as trustee of, and participant in, the Performance Toyota, Inc. 401(k) Profit Sharing Plan, on behalf of himself and on behalf of all similarly situated participants in the plans and shareholders of the Merrill Lynch Growth Fund,

Plaintiffs-Appellants,

versus

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC, MERRILL LYNCH GROWTH FUND, MERRILL LYNCH ASSETT MANAGEMENT, L.P. ARTHUR ZEIKLE, JAMES H. BODURTHA, HERBERT I. LONDON, ROBERT R. MARTIN, JOSEPH L. MAY and ANDRE F. PEROLD, as the Trustees of the Merrill Lynch Growth Fund,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Georgia

(Filed June 7, 2002)

Before BARKETT and MARCUS, Circuit Judges, and HIGHSMITH*, District Judge.

BARKETT, Circuit Judge:

Robert E. Riley and Sheila Cantrell are the trustees of the Performance Toyota, Inc. Profit Sharing Plan ("Performance Plan"), and Gregory Dingle is the trustee of the Master Packaging, Inc. 401(K) plan ("Master Packaging"). Both plaintiffs initially filed a class action[1] in federal district court against Merrill Lynch[2] alleging a violation of two Florida statutes: the Florida Securities and Investor Protection Act (Fla. Stat. Ann. § 517.011 *et seq.*) and the Florida Deceptive and Unfair Trade Practices Act (Fla. Stat. Ann. § 501.201 *et seq.*).[3] The complaint alleged that

* Honorable Shelby Highsmith, U.S. District Judge for the Southern District of Florida, sitting by designation.

[1] The putative class consisted of "all persons and entities who purchased or sold shares of the [Growth] Fund in Florida through Defendant Merrill Lynch Pierce Fenner & Smith, Inc. or any related entity between November 1, 1997 and April 30, 1999." Plaintiffs estimate that both the Master Packaging and Performance Plan classes include thousands of putative class members.

[2] Specifically, the four defendants were Merrill, Lynch, Pierce, Fenner & Smith, Inc., the Merrill Lynch Growth Fund ("Growth Fund"), the individual trustees of the Growth Fund and Merrill Lynch Asset Management. For convenience, we refer collectively to the four defendants as "Merrill Lynch."

[3] The Plaintiffs did not bring any claims directly under federal law.

Merrill Lynch made "material Misrepresentations and Omissions [that] induced the Plaintiffs and other Class members to purchase and retain shares of the Growth Fund. . . ."[4] Merrill Lynch moved to dismiss, arguing (a) that the Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 78bb ("SLUSA") specifically barred the plaintiffs' class action and (b) there was no diversity jurisdiction because one of the Merrill Lynch defendants, the Growth Fund, was required to be treated as a Florida citizen for diversity purposes because it had shareholders who, like the plaintiffs, were Florida citizens. While Merrill Lynch's motion to dismiss was pending, the district court *sua sponte* issued an order to show cause why the complaint should not be dismissed for lack of jurisdiction. Performance Plan responded by filing a Notice of Voluntary Dismissal Without Prejudice and then re-filing its action in state court.[5]

Pursuant to the removal provision of SLUSA, Merrill Lynch immediately removed the Performance Plan action "back" to federal court, where it was "re-consolidated" with the Master Packaging action. Performance Plan moved to remand the action to state court, but the district court denied the motion. Shortly thereafter, the Court issued an order dismissing the complaints of both Performance Plan and Master Packaging under SLUSA and for lack of diversity jurisdiction over the underlying state law claims.

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[4] The purported basis for jurisdiction was diversity. As noted, all claims were brought under Florida state law.

[5] Thus, parallel actions were proceeding in state and federal court, with the Performance Plan plaintiffs in state court and the Master Packaging plaintiffs remaining in federal court.

We review the district court's grant of a motion to dismiss *de novo*. *Lowell v. Am. Cyanamid Co.*, 177 F.3d 1228, 1229 (11th Cir. 1999). We review the district court's jurisdictional rulings and its interpretation of SLUSA *de novo*. *United States v. Hooshmand*, 931 F.2d 725, 737 (11th Cir. 1991).

DISCUSSION

As always, jurisdiction is a threshold inquiry that we are required to consider before addressing the merits of any claim. But the jurisdictional analysis here is complicated by the unique procedural posture of this case. Master Packaging filed suit in diversity directly in federal court, and never left. Thus, the district court was, and this court now is, required to assess whether Master Packaging was diverse from each and every defendant before addressing the merits of its Florida statutory claims and before determining whether SLUSA barred those claims. *See University of S. Ala. v. American Tobacco Co.*, 168 F.3d 405, 412 (11th Cir. 1999).

Performance Plan, in contrast, voluntarily left federal court in response to the district court's jurisdictional inquiry, and re-filed its suit in Florida state court. The only reason Performance Plan found its way back to federal court was that Merrill Lynch removed its state lawsuit pursuant to SLUSA. Because SLUSA was the only basis for removal, the trial court was first required to assess, with respect to Performance Plan, whether SLUSA permitted removal from state to federal court. Because the sequence of analysis differs with respect to each plaintiff, we consider each separately.

I. The Master Packaging Action and Growth Fund's Citizenship

There are two issues raised with respect to Master Packaging's appeal. The threshold issue is whether there is diversity jurisdiction. If we conclude that there is jurisdiction, we must turn to the question whether SLUSA bars Master Packaging's lawsuit. For the reasons set forth below, we conclude that the requisite diversity is lacking. Therefore we do not reach the question of whether SLUSA bars Master Packaging's lawsuit.[6]

Master Packaging sued the Merrill Lynch defendants solely under Florida statutory law and the basis for federal jurisdiction was diversity of citizenship. In order for federal diversity jurisdiction to exist, each defendant must be diverse from each plaintiff. *See Univ. of S. Ala.*, 168 F.3d at 412 (citing *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267, 2 L.Ed. 435 (1806)). Merrill Lynch contends that one of the defendants, Growth Fund, is not diverse from the Florida-based Plaintiffs because some of its shareholders are Florida citizens. Regardless of the fact that the Growth Fund was organized as a business trust under Massachusetts law, Merrill Lynch argues, it should be deemed, for diversity purposes, a citizen of each state in which it has at least one shareholder. Accordingly, Merrill Lynch contends, there is no diversity jurisdiction in this

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[6] As detailed below, we do consider SLUSA's applicability with respect to Performance Plan's lawsuit. We recognize that our application of SLUSA to Performance Plan will, in the abstract, also be applicable to Master Packaging. But because there is no diversity jurisdiction, which is the threshold inquiry in the Master Packaging action, we do not address SLUSA in the context of its appeal.

case because, as a Florida citizen, the Growth Fund is not diverse from the Florida plaintiffs. The trial court, citing *Carden v. Arkoma Assocs.*, 494 U.S. 185, 191-95 (1990), agreed, and so do we.

In *Carden* the Supreme Court held that, for diversity purposes, an Arizona limited partnership was a citizen of each state in which at least one of its general or limited partners was a citizen.[7] *See id.* at 195. In reaching this conclusion, the Court very clearly reaffirmed the doctrinal distinction between corporations on the one hand, and all other types of business entities on the other, stating that only corporations would be treated as citizens of their state of incorporation: "While the rule regarding the treatment of corporations as 'citizens' has become firmly established, we have (with an exception to be discussed presently) just as firmly resisted extending that treatment to other entities." *Id.* at 189. The Court emphasized, "[t]here could be no doubt . . . that at least common-law entities (and likely all entities beyond the Puerto Rican *sociedad en comandita*)[8] would be treated for purposes of the diversity statute pursuant to . . . '[t]he tradition of the common law,' which is 'to treat as legal persons *only incorporated groups* and to assimilate all others to partnerships.'" *Id.* at 190, 110 S.Ct. 1015 (internal citations omitted) (second emphasis added). Thus, the Court stated,

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[7] The district court and the Fifth Circuit had previously ruled that the partnership's citizenship would be based on the citizenship of the general partners alone.

[8] The Puerto Rican *sociedad en comandita* is the only artificial entity that the Court has treated as a traditional corporation for diversity purposes.

"we reject the contention that to determine, for diversity purposes, the citizenship of an artificial entity, the court may consult the citizenship of less than all of the entity's members. We adhere to our oft-repeated rule that diversity jurisdiction in a suit by or against the entity depends on the citizenship of all the members." *Id.* at 195 (internal quotations and citations omitted).

In its extended discussion of *Navarro Sav. Ass'n. v. Lee*, 446 U.S. 458 (1980), *Carden* made clear that the incorporated/unincorporated distinction applies specifically to Massachusetts business trusts, requiring their citizenship to be determined on the basis of the citizenship of their shareholders. *Navarro* was a case involving a Massachusetts business trust that had brought a lawsuit in the names of eight individual trustees, but *not* in the names of the trust itself or its shareholders. *See Navarro*, 446 U.S. at 465-66. The defendants claimed that the plaintiff trust was not diverse from all of the defendants on the basis of the rule that Merrill Lynch urges here, namely, that a trust is a citizen of each state in which it has at least one shareholder. In response, the Court affirmed the general rule cited by the defendants, though it rejected its applicability in *Navarro* because, under the limited facts of the case, the trustees themselves were the real parties in interest. *See id.* In characterizing *Navarro* as affirming the incorporated/unincorporated distinction, the *Carden* Court stated:

Arkoma claims to have found another exception to our *Chapman* tradition[9] in *Navarro Savings Assn. v. Lee,* 446 U.S. 458, 100 S.Ct. 1779, 64 L.Ed.2d 425 (1980). That case, however, did not involve the question whether a party that is an artificial entity other than a corporation can be considered a "citizen" of a State, but the quite separate question whether parties that were undoubted "citizens" (viz., natural persons) were the real parties to the controversy. The plaintiffs in *Navarro* were eight individual trustees of a Massachusetts business trust, suing in their own names. The defendant, Navarro Savings Association, disputed the existence of complete diversity, claiming that the trust beneficiaries rather than the trustees were the real parties to the controversy, and that the citizenship of the former and not the latter should therefore control. In the course of rejecting this claim, we did indeed discuss the characteristics of a Massachusetts business trust – not at all, however, for the purpose of determining whether the trust had attributes making it a "citizen," but only for the purpose of establishing that the respondents were "active trustees whose control over the assets held in their names is real and substantial," thereby bringing them under the rule, "more than 150 years" old, which permits such trustees "to sue in their own right, without regard to the citizenship of the trust beneficiaries." *Id.,* at 465-466, 100 S.Ct., at 1784. *Navarro,* in short, has nothing to do with the *Chapman* question, except that it

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[9] *Chapman v. Barney,* 129 U.S. 677 (1889) initiated the distinction, for diversity purposes, between corporations and unincorporated business entities.

> makes available to respondent the argument by analogy that, just as business reality is taken into account for purposes of determining whether a trustee is the real party to the controversy, so also it should be taken into account for purposes of determining whether an artificial entity is a citizen. That argument is, to put it mildly, less than compelling.

Carden, 494 U.S. at 191-92. In this passage, the Court clearly signals that a Massachusetts business trust – exactly like Growth Fund – is *not* to be accorded the status of a corporation for diversity purposes. Instead, like the limited partnership in *Carden*, it is to be treated as a citizen of each state in which one of its shareholders is a citizen.

Significantly, prior to *Carden* (but based on its underlying precedents) this Court has applied the incorporated/unincorporated distinction in determining the citizenship of trusts on the basis of the citizenship of their shareholders. *See Laborers Local 938 Joint Health & Welfare Trust Fund v. B.R. Starnes Co. of Fla.*, 827 F.2d 1454, 1457 (11th Cir. 1987). In *B.R. Starnes*, we stated that, "Trust Funds, which appear to be voluntary unincorporated associations, are not citizens of any particular state; rather, the citizenship of trust fund *members* is determinative of the existence of diversity of citizenship." *Id.* (emphasis added). Accordingly, we affirmed the district court's dismissal of the complaint for lack of diversity jurisdiction.

Master Packaging argues that the capacity rule of Fed. R. Civ. P. 17(b), in combination with Mass. Gen. Laws ch. 182 § 6, compels us to conclude that Growth Fund is a Massachusetts Citizen for diversity purposes. We disagree.

Fed. R. Civ. P. 17(b) provides that the "capacity of a *corporation* to sue or be sued shall be determined by the law under which it is organized." (emphasis added). Mass. Gen. Laws ch. 182 § 6, under which the Growth Fund was organized, in turn states that "[a]n association or trust may be sued in an action at law for debts and other obligations or liabilities . . . and its property shall be subject to attachment and execution in like manner as if it were a corporation. . . ."

As an initial matter, R.17(b) says nothing whatever about the status of a business trust, dealing, by its express terms, only with the right of a corporation to sue or be sued. It tells us nothing about the similar (or dissimilar) rights of a business trust. If anything, the mention solely of corporations without any reference to other types of business associations reaffirms the doctrinal distinction of *Carden,* distinguishing corporations from other types of business entities.

Mass. Gen. Laws ch. 182 § 6 also tells us nothing about the diversity question at issue here. To begin with, Massachusetts state law cannot prescribe rules to govern federal diversity jurisdiction, and the Supreme Court has clearly stated in *Carden* that unincorporated entities are *not* to be treated as corporations for diversity purposes. In any event, ch. 182 § 6 says nothing about how business trusts should be treated for purposes of *citizenship,* stating only that for purposes of property attachment and execution, they are to be treated in the manner of a corporation.

Thus, the district court correctly determined that complete diversity was lacking between Master Packaging and the Merrill Lynch defendants, requiring the dismissal

of the Master Packaging class action for lack of jurisdiction. As noted, this determination eliminates the need to reach the SLUSA question with respect to Master packaging. However, in order to review the district court's denial of Performance Plan's motion to remand its action to state court (as well as its subsequent dismissal of that action), we must determine SLUSA's applicability to the Performance Plan action.[10]

II. Does SLUSA Apply to Performance Plan's Claims

SLUSA is the most recent in a line of federal securities statutes originating with Congress' passage of the Securities Act of 1933 ("1933 Act"), 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. § 77a *et seq.*), and the Securities Exchange Act of 1934 ("1934 Act"), 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. § 78a *et seq.*), and continuing through Congress' 1995 passage of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub.L. 104-67, 109 Stat. 737 (1995) (codified in part at 15 U.S.C. §§ 77z-1, 78u). In construing the meaning of SLUSA's key terms, we must view SLUSA in this larger statutory context.

The 1933 Act deals with the contents of stock registration statements and prospectuses, giving purchasers a

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[10] Because we determine that Growth Fund must be treated as a citizen of Florida (among other states) for purposes of diversity jurisdiction, there is no need for us to address Merrill Lynch's argument that neither Master Packaging nor Performance Plan meets the amount in controversy requirement for diversity jurisdiction under 28 U.S.C. § 1332.

private right of action against stock issuers who fail to comply with the statute's requirements. In relevant part, the 1934 Act, Section 10, makes it "unlawful for any person ... [t]o use or employ, *in connection with the purchase or sale of any security* registered on a national securities exchange or any security not so registered ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities Exchange Commission ('SEC')] may prescribe. ..." 15 U.S.C. § 78j(2)(b) (emphasis supplied). The SEC accordingly promulgated Rule 10b-5, 17 CFR § 240.10b-5, the basis for a vast amount of modern securities litigation, which provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, *in connection with the purchase or sale of any security.*

17 CFR § 240.10b-5 (emphasis added).

In 1995, after determining that the federal securities laws, and especially § 10b-5, were being abused through the bringing of "strike suits,"[11] Congress passed the PSLRA. The PSLRA set heightened pleading requirements for class actions alleging fraud in the sale of national securities, *see* 15 U.S.C. § 78u-4, and also provided for a mandatory stay of discovery to allow district courts, prior to discovery, to determine the legal sufficiency of claims brought in securities class actions, *see* 15 U.S.C. § 77z-1(b). These reforms were designed to enable securities defendants to obtain early dismissal of frivolous class actions, and thereby avoid the high expense of discovery. *See, e.g., Lander v. Hartford Life and Annuity Ins. Co.*, 251 F.3d 101, 107 (2d Cir. 2001).

By 1998, however, Congress realized that many of the goals of PSLRA were being frustrated because plaintiffs were simply shifting their securities class actions from federal to state court, where the PSLRA did not restrict their claims. *See* Pub.L. No. 105-353 § 2(2).[12] By suing in state court under *state* statutory or common law (rather than under the federal securities laws), litigants were able to circumvent the restrictions placed upon securities claims in federal court. *See id.* To close this loophole in the PSLRA, Congress passed SLUSA, making federal court

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[11] By "strike suits," Congress referred to securities class actions that had no merit, but that were improperly brought for the purpose of forcing securities defendants into large settlements in order to avoid costly discovery. *See* H.R. Conf. Rep. No. 105-803 (1998).

[12] According to a joint House-Senate Committee Report, the decline in federal securities class action suits that occurred after the passage of PSLRA was accompanied by a nearly identical increase in state court filings. *See* H.R. Conf. Rep. No. 105-803 (1998).

the exclusive venue for class actions alleging fraud in the sale of "covered securities." Congress accomplished this by providing for removal of state actions to federal court, and requiring the immediate dismissal of "covered lawsuits." To this end, SLUSA provides, in relevant part:

> (1) Class action limitations
>
> No covered class action[13] based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging –

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[13] SLUSA defines "covered class action" as:

> (i) any single lawsuit in which –
>
> (I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or
>
> (II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or
>
> (ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which –
>
> (I) damages are sought on behalf of more than 50 persons; and
>
> (II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

15 U.S.C. § 78bb(f)(5)(B).

> (A) a misrepresentation or omission of a material fact *in connection with the purchase or sale* of a covered security[14]; or
>
> (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.
>
> (2) Removal of covered class actions
>
> Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).

15 U.S.C. § 78bb(f) (emphasis added).

Thus, in order to remove an action to federal court under SLUSA, the removing party must show that (1) the suit is a "covered class action," (2) the plaintiffs' claims are based on state law, (3) one or more "covered securities" has been purchased or sold, and (4) the defendant

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[14] "Covered security," in turn, is defined as

> a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 77r(b) of this title, at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred. . . .

15 U.S.C. § 77p(f)(3). Section 77r(b)(2) states that:

> [a] security is a covered security if such security is a security issued by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940.

15 U.S.C. § 77r(b)(2).

misrepresented or omitted a material fact *"in connection with the purchase or sale of such security." See Spielman v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.,* No. 01 Civ. 3013 (DLC), (S.D.N.Y. S.D.N.Y. [sic] Oct. 9, 2001) (unpublished opinion); *Shaev v. Claflin,* Fed. Sec. L. Rep. P 91,452 (N.D. Cal. May 17 2001); *Shaw v. Charles Schwab & Co., Inc.,* 128 F. Supp. 2d 1270, 1272 (C.D. Cal. 2001).

SLUSA does not define the term "in connection with the purchase or sale of a covered security." Nor has the Supreme Court yet had occasion to address this phrase in the context of SLUSA, although it has construed and applied the identical phrase as it appears in § 10b-5. *See Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975). As Performance Plan points out, however, one court of appeals and several district courts have had an opportunity to construe the meaning of this phrase in SLUSA. *See Green v. Ameritrade, Inc.,* 279 F.3d 590, 597-98 (8th Cir. 2002); *Shaev,* at 456; *Gordon v. Buntrock,* No. 00 CV 303, (N.D. Ill. Apr. 28, 2000) (unpublished opinion); *Shaw,* 128 F. Supp. 2d at 1273-74; *Gutierrez v. Deloitte & Touche, L.L.P.,* 147 F. Supp. 2d 584, 595 (W.D. Tex. 2001); *Simon v. Internet Wire, Inc.,* Fed. Sec. L. Rep. P 91,408, (C.D. Cal. Apr. 3, 2001); *Burns v. Prudential Sec.,* 116 F. Supp. 2d 917, 922-23 (N.D. Ohio 2000). In interpreting this key term in SLUSA, each of these courts has looked, for guidance, to the law interpreting the same phrase, "in connection with the purchase or sale of a covered security," in the context of § 10b-5. They have done so based on the principle that "[w]here Congress uses terms that have accumulated settled meaning under either equity or the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the

established meaning of these terms." *NLRB v. Amax Coal Co.*, 453 U.S. 322, 329 (1981).[15]

Analogizing to § 10b-5 is particularly appropriate because SLUSA was specifically enacted as an amendment to the 1933 and 1934 Acts (and their successor statutes). In enacting SLUSA, therefore, Congress was not writing on a blank slate; instead, it was legislating in an area that had engendered tremendous amounts of litigation and received substantial judicial attention. In using the phrase "in connection with the purchase or sale of a covered security," Congress was not creating language from a vacuum; instead, it was using language that, at the time of SLUSA's enactment, had acquired settled, and widely-acknowledged, meaning in the field of securities law, through years of judicial construction in the context of § 10b-5 lawsuits. Under these circumstances, we must presume that Congress intended the phrase "in connection with the purchase or sale of a covered security" to have the same meaning in SLUSA that it has in § 10b-5.

Because, in this case, the parties stipulate that the securities involved are "covered securities," that Performance Plan actually purchased shares of Growth Fund, and that Performance Plan's claims are based on state law, the only remaining question is whether the statements

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[15] Relying on 10b-5 case law, federal district courts have held, for example, that SLUSA does not apply to state law claims for breach of fiduciary duty that occurred *after* the sale of the securities in question, *see Hines v. ESC Strategic Funds, Inc.*, No. 3:99-0530, (M.D. Tenn. Sept. 17, 1999) (unpublished opinion), and that SLUSA does not bar a state fraud claim where the alleged fraud caused the plaintiffs to choose a particular brokerage house rather than to buy or sell a particular security, *see Shaw*, 128 F. Supp. 2d at 1273-74.

allegedly made by Merrill Lynch were made "in connection with the purchase or sale of covered securities," and therefore whether Performance Plan's action was properly removed to federal court, and subsequently dismissed, under SLUSA.

Performance Plan argues that its action was properly brought in state court, under state law because Merrill Lynch's alleged misrepresentations caused it to *hold* shares of Growth Fund rather than to "purchase or sell" them. Therefore, Performance Plan argues, its complaint falls outside the scope of SLUSA, which covers only claims involving misrepresentations made "in connection with *purchase or sale.*" Performance Plan asserts that Supreme Court precedent interpreting the phrase "in connection with the purchase or sale of a covered security," in the context of § 10b-5, compels this conclusion. *See Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975). Performance Plan also relies heavily on *Gutierrez v. Deloitte & Touche, L.L.P.,* 147 F. Supp. 2d 584 (W.D. Tex. 2001), which applied *Blue Chip's* § 10b-5 ruling in the context of SLUSA to hold that SLUSA does not cover claims based purely upon "retention" of securities. Subsequent to the briefing in this case, the Eighth Circuit issued *Green v. Ameritrade, Inc.,* 279 F.3d 590 (8th Cir. 2002), which also relied on *Blue Chip* to hold that SLUSA did not bar a state law claim for breach of contract.

In *Blue Chip,* the Supreme Court expressly held that there is no right of action under § 10b-5 unless a challenged misrepresentation or omission caused the plaintiff *actually* to buy or sell a particular stock. *Blue Chip,* 421 U.S. at 727. The plaintiffs in *Blue Chip* brought a class action alleging that Blue Chip had intentionally issued an overly pessimistic prospectus in order to dissuade them

from purchasing Blue Chip stock in accordance with their first-purchase right, so that the stock could later be sold to the public at a higher price. Because they had rejected Blue Chip's offer to buy at the initial low price as a result of the misleading prospectus, the plaintiffs sought the right to buy the stock – which had since risen dramatically – from Blue Chip at the original price. The Court framed the central question in the case as follows: "whether respondent may base its action on Rule 10b-5 of the Securities and Exchange Commission without having either bought or sold the securities described in the allegedly misleading prospectus." *Id.* The Court answered the question in the negative, making clear that § 10b-5's cause of action is limited to "actual purchasers or sellers" of stock. It also noted however, that "[o]bviously, this disadvantage is attenuated to the extent that remedies are available to nonpurchasers and nonsellers under *state law.*" *Id.* at 738 n. 9 (emphasis supplied). In so stating, the Court recognized that while "holding" claims are not actionable under the federal securities laws, they may well be actionable under state laws that are more stringent than their federal counterparts.

Based substantially on the rule of *Blue Chip,* the Eighth Circuit held, in *Green,* that SLUSA did not bar a state law claim for breach of contract where the plaintiffs failed to allege that the defendants made misrepresentations that caused them to buy or sell a covered security. Green sued Ameritrade for breach of contract in state court alleging that he had contracted with Ameritrade to receive "real time" stock quotes on Ameritrade's web site, but the quotes provided were not "real time." Ameritrade removed under SLUSA, claiming that the suit was really one for misrepresentations made "in connection with the

purchase or sale of a covered security." The trial court held that Green's claim was not a securities fraud claim within the purview of SLUSA, but simply a claim for breach of contract, and the Eighth Circuit affirmed. *See Green,* 279 F.3d at 598-99. In reliance on *Blue Chip,* the *Green* Court stated:

> [T]he critical question is whether Green's amended complaint can reasonably be read as alleging a sale or purchase of a covered security made in reliance on the allegedly faulty information provided to himself and to putative class members by Ameritrade . . . Green's amended complaint completely omits any mention of such reliance. He alleges no sale or purchase of a covered security, only that he did not receive the type of information from Ameritrade for which he believed he had contracted and paid twenty dollars monthly. We are satisfied that nothing in Green's amended complaint suggests that his cause of action arises from a sale or purchase of a security in reliance on information gained from Ameritrade's real-time quote service. The amended complaint simply is not susceptible to being read as alleging anything of the sort. It therefore does not satisfy the criteria for SLUSA preemption.

Id.

Also relying on *Blue Chip,* the federal district in *Gutierrez* held that SLUSA does not apply to claims of misrepresentations that caused plaintiffs to *retain* securities, rather than actually to buy or sell them. In *Gutierrez,* the plaintiffs brought a class action alleging that the defendant's acts of "accounting misfeasance" caused them

to hold securities that they otherwise would have sold. Specifically, the complaint identified a subclass of

> [a]ll persons or entities that *held* any "covered security" as that term is defined in the Private Securities Litigation Reform Act of 1995 at all relevant times through 1993 through present and did not sell or otherwise dispose of said products prior to June 1999. . . .

Gutierrez, 147 F.Supp.2d at 592 (emphasis added).

In arguing that SLUSA did not bar their claim, but that they were entitled to bring their retention claim in state court, under state law, the *Gutierrez* plaintiffs argued (in the court's words), that:

> category (iii) is explicitly limited to damages caused by the holding of covered securities and the loss of value which resulted from such holding. [It does not seek] purchaser or seller damages arising out of any alleged misrepresentation which may or may not have occurred when the [plaintiffs] purchased the covered stock. Rather, plaintiffs seek damages for being fraudulently induced to continue to hold stock after they and the category (iii) putative class members had purchased the securities. Plaintiffs maintain they are not asserting a claim "in connection with the sale or purchase" of a covered security and thus their claims are not subject to mandatory removal under the SLUSA.

Id.

Based on *Blue Chip,* the court held that retention claims were not claims of misrepresentations "in connection with the purchase or sale of a covered security," and that the plaintiffs, therefore, were entitled to bring those

claims in state court. The court emphasized that "plaintiffs have 'gone to great lengths' to stress that their first amended petition alleges misrepresentations *only* in the holding of covered securities." *Id.* at 593 (emphasis added). The Court further stated:

> Although the stocks purchased by subclass category (iii) claimants are covered securities for purposes of the Act, the first amended petition alleges misrepresentations only in the holding of these covered securities and nowhere do plaintiffs allege subclass category (iii) includes purchasers. Rather, as plaintiffs argue, they have "expressly carved out and excluded [purchasers] when they elected to allege only claims for *holding* covered securities, not the purchase or sale of covered securities."

Id. (emphases in original).

We agree with the *Gutierrez* court, that under *Blue Chip,* SLUSA does *not* apply to claims dealing *solely* with the retention of securities, rather than with purchase or sale. We also agree with the *Gutierrez* Court's implication, however, that when a claim that sweeps within its ambit actual purchases or sales of stock *is* covered by SLUSA, a plaintiff may not avoid SLUSA's restrictions simply by alleging that a given misrepresentation caused him *both* to purchase and hold a particular security.

For this reason, we agree with the district court that Performance Plan's suit is covered by SLUSA, and was not properly brought in state court, under state law. The simple fact is, unlike the carefully-crafted allegations in *Gutierrez,* Performance Plan's allegations in this case are not limited solely to the retention of covered securities. Paragraph 37, which Performance Plan submits as the

principal source of its retention claim, states that Merrill Lynch made "material Misrepresentations and Omissions [that] induced the Plaintiffs and other Class members to *purchase and retain* shares of the Growth Fund during the Class Period." (emphasis added). This language clearly alleges that Merrill Lynch's conduct caused Performance Plan to *purchase* covered securities and as [sic] retain them. The fact that class members purchased *and then retained* their Growth Fund shares does not necessarily add anything to the basic claim of purchasing, because all investors, by definition, hold their shares for at least some time after purchase. Thus, while in principle we agree with Performance Plan's argument that SLUSA does not apply to "holding" claims, and that such claims accordingly may be brought in state court, under state law, we do not find that the rule applies in this case.

Alternatively, Performance Plan argues that SLUSA does not apply to state law claims that lack the scienter requirement of the federal securities laws. Performance Plan's syllogistic argument appears to be as follows: Congress did not intend to bar claims pursuant to state laws that are *stricter* than federal securities laws; Performance Plan's state claims do not require scienter and are thus stricter than federal securities laws; therefore Performance Plan's lawsuit is not preempted by SLUSA.[16]

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[16] *See* H.R. Conf. Rep. No. 105-803, at *2; *Compare Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 (1976) (acknowledging scienter requirement of federal securities laws), *and Messer v. E.F. Hutton & Co.,* 833 F.2d 909, 916 (11th Cir. 1987), *with W.S. Badcock Corp. v. Myers,* 696 So.2d 776, 779 (Fla. Dist. Ct. App.1996) (no scienter requirement in Florida securities laws), and *Davis v. Powertel, Inc.,* 776 So.2d 971 (Fla. Dist. Ct. App. 2000) (DUTPA liability is objective;

(Continued on following page)

In support of this argument, Performance Plan relies on the district court opinion in *Green, supra,* (reported at 120 F.Supp.2d 795 (D.Neb.2000)), and *Burns v. Prudential Sec.,* 116 F. Supp. 2d 917 (N.D. Ohio 2000). Performance Plan claims these cases stand for the proposition that the presence or absence of scienter in a state law securities claim is the determinative factor in deciding whether a pleaded state law claim is a mere substitute for the federal securities laws and, therefore, whether it is barred by SLUSA.

Initially, we find Performance Plan's reliance misplaced. Neither of the cases cited can support this proposition. *Burns* was a class action brought in state court by clients of Prudential Securities who alleged that over the course of a two-day period, one of Prudential's brokers liquidated their accounts without permission. The plaintiffs brought state law claims for conversion, breach of contract, breach of fiduciary duties, and negligent supervision. Prudential removed to federal court under SLUSA and the plaintiffs moved to remand. The district court granted the motion to remand, holding that SLUSA did not apply because the plaintiffs' claims, while related to securities, were *not* claims for securities *fraud* at all. No misrepresentation was alleged in that case. *See Burns,* 116 F.Supp.2d at 924. As noted above, exactly the same thing is true of *Green*. Thus, neither of these cases are applicable to Performance Plan's claim and we have found no case to support the proposition that the absence of scienter in a

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question is whether the practice complained of was likely to deceive a consumer acting reasonably in the same circumstances).

state securities claim suffices to remove it from SLUSA's scope.

More fundamentally, the premise of Performance Plan's argument is incorrect. SLUSA amends both the 1933 Act (15 U.S.C. § 77p) and the 1934 Act (15 U.S.C. § 78bb), preempting claims brought under both of those statutes. The sections of SLUSA that amend the 1933 Act track the language of §§ 11 and 12(a)(2), and claims under §§ 11 and 12(a)(2) of the 1933 Act do not require a showing of scienter. Thus, SLUSA preempts *some* claims – namely, those brought under § 11 or 12(a)(2) of the 1933 Act – that lack a scienter requirement. Accordingly, we cannot accept Performance Plan's contention that scienter is the dispositive factor in determining whether a given lawsuit falls within the scope of SLUSA.

In sum, we find no merit to Performance Plan's argument that the district court erred in declining to remand its lawsuit to state court, and in subsequently dismissing the action.

III. SLUSA is Constitutional

Finally, the plaintiffs argue that SLUSA is unconstitutional because it exceeds Congress' power under the Commerce Clause.[17] We readily disagree.

The Supreme Court has identified three categories of conduct that Congress may regulate under the Commerce Clause: (1) the use of the channels of interstate commerce;

[17] The plaintiffs also argue that SLUSA violates the Equal Protection clause. This argument lacks merit.

(2) the instrumentalities of interstate commerce, or persons or things in interstate commerce; and (3) activities that substantially affect interstate commerce. *United States v. Lopez*, 514 U.S. 549, 558-59 (1995). Within each category, Congress' regulatory power is plenary. *Id.*

SLUSA regulates only national securities markets and expressly deals with claims pertaining to nationally-traded securities. As the district court recognized, "both the securities in question and the defendant in this action are entrenched in interstate commerce." SLUSA defines a "covered security" as "a security issued by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940." The Growth Fund shares in this case are federally-registered securities and Merrill Lynch's trading operations for Growth Fund shares extend throughout the country. SLUSA thus is constitutional because it regulates both "channels" of interstate commerce (*i.e.*, national securities markets) and "things" in interstate commerce (*i.e.*, nationally-traded securities themselves). Indeed, though it has addressed the 1933 and 1934 securities Acts on countless occasions, the Supreme Court has never invalidated any part of either statute (which SLUSA amended) – or for that matter, any federal statute regulating the national securities markets – on Commerce Clause grounds. *See e.g., North Am. Co. v. SEC*, 327 U.S. 686, 796 (1946) (rejecting Commerce Clause challenge to Section 11(b)(1) of the 1933 Act because it is long established "that Congress may deal with and affect the ownership of securities in order to protect the freedom of commerce").

CONCLUSION

Because there is no diversity jurisdiction in this case, the district court properly dismissed Master Packaging's action. We also find that SLUSA is clearly constitutional and applies to Performance Plan's state court lawsuit. Therefore, the district court correctly denied its motion for remand and correctly dismissed that suit. The orders of the district court, therefore, are

AFFIRMED.

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

ROBERT E. RILEY, JR., et al.,

Plaintiffs,

v.

Case No. 8:00-cv-2335-T-30B

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., et al.,

Defendants.

ORDER

(Filed Sep. 27, 2001)

This cause is before the Court upon Defendant's Motion to Dismiss and supporting memorandum (Dkts. 4 & 5) and Plaintiff's response in opposition thereto (Dkt. #21).

I. PROCEDURAL HISTORY

The Plaintiffs in *Riley, et al. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.,* Case No. 8:00-CV-2335-T-30TGW ("Riley I") originally filed a class action alleging that Defendants violated two Florida statutes, the Florida Securities and Investor Protection Act, Fla. Stat. §§ 517.011, *et seq.,* and the Florida Deceptive and Unfair Trade Practices Act, Fla. Stat. §§ 501.201, *et seq.,* by misrepresenting and omitting material facts concerning the Merrill Lynch Growth Fund to induce Plaintiffs to invest.

After the case was filed, Defendants moved to dismiss Plaintiffs' claims arguing that the 1998 Securities Litigation Uniform Standards Act ("SLUSA") barred Plaintiffs from maintaining their claims. Defendants also argued that dismissal was appropriate because the Complaint failed to adequately allege diversity jurisdiction.

While Defendants' Motion to Dismiss was pending, the Court began its initial jurisdictional review of the case. As part of the jurisdictional review, the Court *sua sponte* entered an Order requiring the Plaintiffs to show cause why diversity jurisdiction was appropriate. The Plaintiffs responded to the show cause Order and contemporaneously filed a Notice of Voluntary Dismissal Without Prejudice as to the claims relating to Performance Toyota, Inc. 401(k) Profit Sharing Plan ("Performance Plan"). Plaintiffs' response to the show cause Order explained that the claims relating to the Performance Plan were being dismissed because they may not meet the amount in controversy requirement and therefore federal jurisdiction was not appropriate on those claims. After voluntarily dismissing the claims relating to the Performance Plan, Plaintiffs re-filed the identical claims in state court ("Riley II"). The Defendants then removed Riley II from state court back to federal court pursuant to the removal provision of SLUSA and the case was assigned Case No. 8:01-CV-779-T-30TGW.

Upon removal, Riley II was assigned to the Honorable Richard Lazzara, who subsequently filed a Notice of Recusal. Riley II was reassigned to this division pursuant to standard reassignment procedures. As a result, both Riley I and Riley II are now before the Court. The Plaintiffs in Riley II filed a Motion to Remand the case back to state court. This Court denied the Motion to Remand and

consolidated the two cases. Pursuant to 28 U.S.C. 2403(a), the Court certified to the Attorney General the fact that these cases involve issues concerning the constitutionality of an Act of Congress affecting the public interest. The Attorney General declined to intervene.

It is noted that the two original cases present substantially the same arguments and defenses. The Court's legal analysis below extends fully to the issues raised in both original Riley actions, which are now consolidated before this Court.

II. LEGAL DISCUSSION

The Plaintiff argues that application of SLUSA would be unconstitutional in this case because SLUSA can not constitutionally bar an action grounded entirely in state law. SLUSA provides, in relevant part, as follows:

> (f) Limitations on remedies
>
> (1) Class action limitations: No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging –
>
> (A) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or

sale of a covered security. 15 U.S.C. § 78bb(f); 15 U.S.C. § 77p(b).

This Court has already determined that the issues raised in both Riley I and Riley II fall within the definition of a "covered class action" under the terms of SLUSA (Order Denying Motion to Remand and Consolidating Cases, Dkt. # 41). It now must determine if the application of SLUSA preempts the relevant state laws, and if the application of SLUSA to the state law claims in this case reaches beyond Congress' power to regulate commerce and is, therefore, unconstitutional.

A. DOES SLUSA PROHIBIT THE PLAINTIFFS FROM PROCEEDING WITH THEIR STATE LAW CLAIMS

It is well established that federal law may preempt state law in three ways. First, Congress may define the extent to which it intends to preempt state law. *Michigan Canners and Freezers Ass'n. Inc. v. Agricultural Marketing and Bargaining Bd.* 467 U.S. 461, *469, 104 S.Ct. 2518, **2523 (1984) Second, Congress may indicate an intent to occupy an entire field of regulation. *Id.* Third, Congress may preempt a state law which conflicts with federal law. *Ia.* Such a conflict may be express, or it may arise when a state law stands as an obstacle to the accomplishment of the purpose and objective of Congress in enacting legislation. *Id.*

The Court accepts Plaintiff's proposition that Congress has not evidenced an intent to occupy the entire field of securities regulation. However, the Court finds that Congress has, through SLUSA, preempted a portion of Florida State Law. Namely, Congress has preempted state

law to the extent that it provides an avenue for recovery for a "covered class action" through the state courts. Congress clearly states the intended purpose of SLUSA:

> The Congress finds that – (1) the Private Securities Litigation Reform Act of 1995 sought to prevent abuses in private securities fraud lawsuits; (2) since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts; (3) this shift has prevented that Act from fully achieving its objectives; *2 (4) State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote strong financial markets; and (5) *in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.*
>
> H.R. CONF. REP. 105-803, *2 (emphasis added)

It is clear that Congress, by enacting SLUSA, intended to prevent exactly the kind of action which is now before the Court. This Court finds the subject matter of this litigation to be in direct conflict with the provisions of SLUSA prohibiting the pursuit of "covered class actions" in state or federal court. 15 U.S.C.A. § 78bb(f).

The Court acknowledges the case of *Green v. Fund Asset Management, L.P.,* 245 F.3d 214 (3d Cir. March 16,

2001), which was provided by Plaintiffs as supplemental authority. Plaintiff directs the Court to the language, "It is well settled that federal law does not enjoy complete preemptive force in the field of securities; state securities laws exist in every state, the District of Columbia, and Puerto Rico, and 'far from preempting the field,' congress has expressly reserved the role of states in securities regulation." *Id.* at note 7. This language does not alter the application of SLUSA in this case.

As is clear by the language of the House Report, SLUSA does not attempt to preempt all state law in the field of securities. H.R. CONF. REP. 105-803, *infra.* Rather, SLUSA bars a specific form of action based on a specific set of facts, namely a class action arising under the enumerated circumstances described in SLUSA. *Id.* The operative language in SLUSA poses no bar to pursuit of individual actions regarding securities in state courts, or to class actions which fall outside of the limitations of 15 U.S.C.A. § 78bb(f).

Additionally, the facts of *Green* are materially different than those presented in this case. The Defendants in *Green* asserted that the state law claim of breach of fiduciary duty should be barred because of "conflict preemption," *Green,* 245 F.3d at 222. The Court analyzes the legislative history of the federal law and the applicable Senate Report, finding that Defendants did not demonstrate that Congress intended to eliminate common law access to the remedies in question. *Id.* at 226. To the contrary, Congress' stated purpose in enacting SLUSA was to bar class actions of the exact nature of that in the instant case arising under state or federal laws. H.R. CONF. REP. 105-803, *infra.* If this Court utilizes the same

analytical framework presented in *Green,* a quite different result is obtained.

Since the facts in *Green* are materially different than those before the Court in the instant case, the Court is not bound by the decision of the Third Circuit. The Court is persuaded by the decision of the district court in *Hines v. ESC Strategic Funds, Inc.,* et al., 1999 WL 1705503 (M.D. Tennessee (1999), which addressed facts similar to those in the instant case. Among other things, the defendants in *ESC Strategic* sought to have the Plaintiff's state law claims dismissed, contending they were barred by SLUSA. *Id.* at 3. With regard to the Plaintiff's claims under state securities fraud law, the court states:

> Plaintiff further alleges that "Defendants also made or caused to be made statements which at the time and in light of the circumstances under which they were made were false and misleading with respect to material facts as set forth herein, in violation of T.C.A. ¶¶ 48-2-121(c)." (First Amended Complaint at ¶¶ 31) Clearly, this claim is preempted under the Uniform Standards Act because the claim is based on allegations of untrue statements, omissions of material facts, and manipulative or deceptive devices. This claim is dismissed with prejudice. *Id.* at 5.

While the Court is not bound by the decision of the District Court in *ESC Strategic,* it finds the court's analysis both persuasive and applicable in the instant case.

Plaintiffs also argue that, since the Florida Statutes in question do not contain a "scienter" requirement, SLUSA should not preempt. The Court has already addressed Plaintiff's arguments regarding "scienter" and preemption by SLUSA in the Order Denying Motion to

Remand and Consolidating Cases. (Dkt. #41). The Court previously found that the action in this case is properly considered a "covered class action" under SLUSA, stating: "Plaintiffs' claims in Riley II are brought pursuant to statutory law and allege misrepresentations or omissions of material fact in connection with the purchases and sales of fund shares." (Order Denying Motion to Remand and Consolidating Cases, Dkt. #41)

Plaintiff next argues that Florida is able to enact regulations that are more strict than Federal standards. The Court agrees with Plaintiff's argument that, as a principal, a state may enact a more restrictive statute than that imposed by federal law. However, this theory is misapplied in the instant case. Preemption in this case alters the remedy and forum of the would-be class; it does not eradicate the state statute altogether. The state statute, be it more restrictive or not, is still fully operational as it applies to individual plaintiffs. Plaintiffs suggest that to prohibit class actions but allow individual actions regarding this subject matter would "turn logic on its head." The Court rejects this argument. Instead, it appears that Congress' intent was to do exactly that; to allow individuals to pursue claims under state or federal law, but to limit covered class actions to the remedies provided through federal securities regulations.

In the alternative, the Plaintiffs argue that SLUSA impermissibly infringes upon the Supreme Court's rule making authority. Specifically, the Plaintiff asserts that class action litigation is governed by Fed. R. Civ. P. 23, and that SLUSA must be interpreted so as to avoid any repeal by implication of Rule 23. Plaintiff quotes the following language from the Rules Enabling Act:

> (a) The Supreme Court and all courts established by Act of Congress may from time to time prescribe rules for the conduct of their business. Such rules shall be consistent with Acts of Congress and rules of practice and procedure under section 2072 of this title. 28 U.S.C. § 2071.

The Court is unpersuaded by the proposition that applying SLUSA to the instant case would run contrary to the provisions of the Rules Enabling Act. Even the language cited by Plaintiffs makes clear that the courts must conform their rules to the Acts of Congress, not vice versa. Further, SLUSA does not eliminate the vehicle of the class action lawsuit from the American legal system; it applies a limitation on use of the class action in connection with the specific category of actions enumerated within the Act.

B. IS SLUSA CONSTITUTIONAL AS APPLIED IN THIS CASE

It is undisputed that Congress possesses the authority to regulate interstate commerce. *Constitution of the United States,* Section 8, Clause 3. Plaintiffs argue that the claims raised in this case arise under Florida law and do not implicate interstate commerce. As such, Plaintiffs assert that application of SLUSA to the actions in this case would be an unconstitutional exercise of congressional authority to regulate interstate commerce. However, this approach fails to consider the broader context of the case at bar.

While the plaintiffs are residents of Florida, elected to participate in the subject plans in Florida, received status updates and reports in Florida, and filed suit under Florida law, these facts alone do not obscure the interstate nature of the underlying transactions. It is undisputed that the subject of this litigation are 401K investment

funds, each composed of nationally traded securities. The assertion that the fraudulent or deceptive promotion and sales of nationally traded securities is outside the reach of the commerce clause is without merit. Additionally, it is undisputed that the Defendant's principal place of business and the residences of the Fund's trustees are all outside of the state of Florida, the trust itself was administered from outside of Florida, and yet defendants were actively recruiting Fund participants in Florida.

The Supreme Court has held that the existence of some intrastate activity does not prelude exercise of the clause's regulatory provisions, where the principal business of the entity in question is of an interstate nature:

> But so far as the commerce clause alone is concerned Congress has plenary power, a power which "extends to every part of interstate commerce, and to every instrumentality or agency by which it is carried on; and the full control by Congress of the subjects committed to its regulation is not to be denied or thwarted by the commingling of interstate and intrastate operations." The Minnesota Rate Cases (*Simpson v. Shepard*), supra, 230 U.S. at page 399, 33 S.Ct. at page 739, 57 L.Ed. 1511, 48 L.R.A., N.S., 1151, Ann.Cas. 1916A, 18.
>
> *North Am. Co. v. Securities and Exchange Commission* 327 U.S. 686, *705, 66 S.Ct. 785, **796 (1946)

Although the Plaintiffs wish to avoid preclusion by SLUSA, it is clear that both the securities in question and the defendant in this action are entrenched in interstate commerce. The mere existence of some intrastate activity does not move this action beyond the reach of interstate

commerce regulation by Congress. Although Plaintiff are residents of Florida and brought claims under Florida law, the foundation of this action and the activities giving rise to the action are interstate in nature.

C. DIVERSITY JURISDICTION

The Court has also considered the parties' arguments concerning diversity jurisdiction in this case. Defendant, Merrill Lynch Growth Fund, is a Massachusetts business trust. Defendants assert that the citizenship of a business trust is the citizenship of all of the shareholders of the trust. Plaintiffs, on the other hand, argue that the Fund has the capacity to sue and be sued under the law of the state of its' organization, and should be treated as a corporation for diversity purposes.

In support of their position, Plaintiffs cite the law of Massachusetts, which state that a business trust "while not a corporation is a separate legal entity for the purpose of being sued." Chapter 182, Annotated Laws of Massachusetts. Plaintiffs argue that the case of *Carden v. Arkoma Associates,* 494 U.S. 185, *189, 110 S.Ct. 1015 (1990), is distinguishable from the case at bar. Specifically, Plaintiff asserts that the two cases are not comparable because *Arkoma* deals with diversity jurisdiction as it applies to a limited partnership, not a business trust. However, the Court in *Arkoma* directly addresses the treatment of all entities not incorporated with regard to diversity jurisdiction:

> While the rule regarding the treatment of corporations as "citizens" has become firmly established, we have (with an exception to be discussed presently) just as firmly resisted

> extending that treatment to other entities. *Id.* at 1018 [1]

The Court goes on to address the very argument which Plaintiffs assert entitles them to a finding of diversity jurisdiction:

> Similarly, in *Great Southern Fire Proof Hotel Co. v. Jones,* 177 U.S. 449, 20 S.Ct. 690, 44 L.Ed. 842 (1900), we held that a "limited partnership association" – although possessing "some of the characteristics of a corporation" and deemed a "citizen" by the law creating it – may not be deemed a "citizen" under the jurisdictional rule established for corporations. *Id.*, at 456, 20 S.Ct., at 693. "That rule must not be extended." *Id.*, at 457, 20 S.Ct., at 693. As recently as 1965, our unanimous opinion in *Steelworkers v. R.H. Bouligny, Inc.,* 382 U.S. 145, 86 S.Ct. 272, 15 L.Ed.2d 217 reiterated that "the doctrinal wall of *Chapman v. Barney,*" *id.*, 129 U.S., at 151, 86 S.Ct., at 275, would not be breached. *Id.*

The Court clearly states that the status given to corporations with regard to diversity jurisdiction is to be extended to no other entities, without regard to the status afforded to such entities in the states from which they originate.

The Court finds *Arkoma* applicable and controlling of the case at bar. Diversity must be based on the citizenship of the shareholders of the trust. It is undisputed that some

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[1] The "exception" referenced by the Court relates to an entity under the civil law of Puerto Rico, known as a *socieded en comandita. Id.* at 190. The exception has no bearing on the issues presented in this case.

of the shareholders are residents of Florida. Therefore, complete diversity does not exist. Since the Court finds that complete diversity does not exist, it is not necessary to resolve the dispute regarding adequacy of the amount in controversy for jurisdictional purposes.[2]

D. CONCLUSION

As expressed in detail above, this Court finds that application of SLUSA in this case is a constitutional exercise of congressional authority to regulate interstate commerce. The Court previously found that this action fell within the definition of "covered class action" as set forth under SLUSA. The class action is subject to the provisions of SLUSA, which clearly state that such a cause of action shall not be heard in any state or federal court. Furthermore, the Court finds that diversity jurisdiction is not appropriate in this case. The class action claim is dismissed based on 15 U.S.C.A. § 78bb(f), leaving the parties with individual actions and no basis for federal jurisdiction. As a result, the Court finds the parties are not properly before this Court.

Accordingly, it is **ORDERED** and **ADJUDGED** that Defendant's Motion to Dismiss (Dkt.#4) is **GRANTED**. The clerk is directed to close this file.

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[2] The Court acknowledges the circuit split regarding the relationship between 28 U.S.C. § 1367 and the Supreme Court's holding in *Zahn v. International Paper Co.*, 414 U.S. 291 (1973). Since the Court has found this action to be improperly before the Court for independent jurisdictional reasons, it is not necessary for the Court to interpret the conflicting precedent regarding the amount in controversy at this time.

DONE and **ORDERED** in Tampa, Florida on September 27, 2001.

/s/ James S. Moody, Jr.
JAMES S. MOODY, JR.
UNITED STATES DISTRICT JUDGE

Copies furnished to:

Counsel of Record
Unrepresented Parties

U.S. Const., Art. 1 § 8

Section. 8.

Clause 1: The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

Clause 2: To borrow Money on the credit of the United States;

Clause 3: To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

Clause 4: To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

Clause 5: To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;

Clause 6: To provide for the Punishment of counterfeiting the Securities and current Coin of the United States;

Clause 7: To establish Post Offices and post Roads;

Clause 8: To promote the Progress of Science and useful Arts, by securing for limited times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;

Clause 9: To constitute Tribunals inferior to the supreme Court;

Clause 10: To define and punish Piracies and felonies committed on the high Seas, and offences against the Law of Nations;

Clause 11: To declare War, grant Letters of Marque and Reprisal, and make Rules concerning Captures on Land and Water;

Clause 12: To raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years;

Clause 13: To provide and maintain a Navy;

Clause 14: To make Rules for the Government and Regulation of the land and naval Forces;

Clause 15: To provide for calling forth the Militia to execute the Laws of the Union, suppress Insurrections and repel Invasions;

Clause 16: To provide for organizing, arming, and disciplining, the Militia, and for governing such Part of them as may be employed in the Service of the United States, reserving to the States respectively, the Appointment of the Officers, and the Authority of training the Militia according to the discipline prescribed by Congress;

Clause 17: To exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings; – And

Clause 18: To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

U.S. Const., Amend. X

Reserved Powers to States

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.